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SUBJECT: Dongguan Officials Express Optimism But Acknowledge Economic Challenges

REF: A) Guangzhou 618, B) Guangzhou 692, C) Guangzhou 696, D) Guangzhou 715

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¶1. (SBU) Summary: Government officials in Dongguan, a major manufacturing center in the heart of the Pearl River Delta between Guangzhou and Shenzhen, are doing their best to put a positive spin on the city's economic prospects. They express hope that Dongguan's growth in 2009 will be comparable to 2008 levels -- running at 15.1 percent in the first ten months -- and challenged the notion that factories in the city are closing down in larger numbers than in previous years. Nevertheless, they acknowledged the effects of the global financial storm that's hitting this export-reliant region earlier and harder than most other parts of China, saying that Dongguan has never before faced such a severe situation. They described various steps the city is taking in coordination with central and provincial officials to shore up the economy. The officials also indicated that Dongguan is encouraging labor-intensive export processing firms to stay in the area and upgrade rather than move to more remote areas of the province as envisioned in Guangdong Party Secretary's "double-transfer" policy.

The tone of the officials differs significantly from that of investors in the city (ref D), but it's clear they agree on one key issue: Dongguan is facing tough times ahead. End summary.

¶2. (SBU) Comment: Some media reports and Consulate contacts have suggested that there is a significant difference of opinion between Guangdong Party Secretary Wang Yang, who has spearheaded the "double transfer" campaign, and central government senior leadership, particularly Premier Wen Jiabao, on what steps if any the government should take to aid failing SMEs in the Pearl River Delta. Wang Yang has been quoted calling the closed firms "backward productive forces" and said it was good that they were closing. Central government officials appear more concerned about the threat to social stability these closures and subsequent unemployment could represent. Wang Yang may face resistance from above and below with municipalities like Dongguan eager to keep firms that might otherwise be targeted for relocation. This internal debate will likely continue with significant impact on Guangdong's economic policies as well as Wang Yang's political future. End comment.

Hoping for Stable Growth Levels

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¶3. (SBU) Despite media reports of widespread factory closures, migrant workers returning home in large numbers and enterprise concerns about falling orders (confirmed by the December 10 announcement that China's export declined in November by 2.2 percent nationally), Dongguan Development and Reform Council (DRC) Deputy

Director Wang Zhaohong told us that growth in the city has remained stable and showed good momentum. He believes that Dongguan could see growth next year at about the same level as this year. In the first ten months, Dongguan's economy grew at 15.1 percent, 2.4 percentage points lower than last year's but still higher than the projected 14 percent, according to Wang. He cited other positive data, including 21.5 percent growth in the city's retail sales, export growth of 14.3 percent and growth in utilized FDI of 16.7 percent. Dongguan Bureau of Foreign Trade and Economic Cooperation (BOFTEC) Deputy Director Fang Jianbo offered some of the same statistics in presenting a similar case for why Dongguan's prospects didn't look too bad.

¶ 14. (SBU) DRC's Wang also argued that the number of factories that have shut down in Dongguan was about the same as in previous years. He pointed out that the number of foreign-invested enterprises (FIEs) in Dongguan was stable at about 15,000. According to government statistics more companies have opened in Dongguan this year than closed, he said. (Note: Per ref D, other contacts have criticized government data on factory closures, arguing that they only count companies that have completed the necessary paperwork to formally de-register. End note.) BOFTEC's Fang asserted that even though more than 600 FIEs shut down during the first ten months, this was not unusual and the annual average was 744 closures. He noted that of the 37,000 FIEs that have been established in Dongguan since 1978, 21,000 have eventually closed.

#### Unable to Ignore Difficulties and Hard Times Ahead

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¶ 15. (SBU) However, Wang acknowledged that Dongguan had never before faced such severe challenges. He noted that the difficulties had preceded the global financial crisis as central government policies E

that removed benefits for export processing industries further exacerbated rising wages and increases in other input costs. Wang believes that Dongguan is being hit harder than any other part of Guangdong Province because of the high concentration of labor-intensive export manufacturers.

¶ 16. (SBU) Wang predicted industrial output would fall in the coming months as many factories downsize, restructure and search for new business models. BOFTEC's Fang said that the number of FIEs might fall by 100 in December and again as many in January. Even as he speculated that more small and medium-sized enterprises (SMEs) would likely close in early to mid-2009 if orders don't start to rise and costs continue to grow, Fang pointed out that previously closed FIEs had recently reopened in three different Dongguan townships.

#### Ready to Help

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¶ 17. (SBU) China's government is taking steps at various levels to help SMEs survive the crisis, according to DRC's Wang. Dongguan is following the lead of the central and provincial governments by implementing a stimulus package of its own worth RMB 140 billion (about USD 20 billion). Wang told us that the municipal government had sufficient funds available for the package. He also described the city's "six one-billion" campaign to allocate up to RMB 1 billion to provide support to SMEs in six target areas -- research and development, start-ups, industrial upgrading, interest payments, waivers of administrative fees, and tariff guarantee deposits. In addition, Fang pointed out that the city was setting up an early warning system to warn of potential factory closures and was considering a new unemployment insurance scheme. He said that the city government's efforts had contributed to Beijing's decision to restore VAT rebates for exports and other policies beneficial to SMEs in Dongguan.

#### "Double Transfer" Going Nowhere

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¶ 18. (SBU) Contrary to the Guangdong provincial government's strategy of moving labor-intensive manufacturing away from the Pearl River Delta area to less developed parts of the province, both the DRC and BOFTEC officials said Dongguan plans to encourage these firms to upgrade their manufacturing technology and products but not to

relocate. Wang said that a few companies had moved to more remote areas recently but called the number insignificant. He and Fang each highlighted elements of the "six one-billion" plan as part of the city's effort to encourage firms to upgrade. Fang told us that BOFTEC also facilitates registration as wholly-owned foreign enterprises (WOFEs) without administrative fees to better allow local FIEs to access the domestic market.

Making Sense of the View from Dongguan

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**¶9. (SBU) Comment:** Investors and officials in Dongguan each present substantially different views of the economic situation facing this important manufacturing center (ref D). The numbers and the tone differ, but it's clear that both sides are deeply concerned about what might be around the corner. Projections of growth and positive numbers aside, the government officials acknowledge that these are very challenging times and are quick to describe the steps they're taking to aid firms. The Dongguan investors have praised the responsiveness of the local government to their concerns. None of the parties involved have a clear picture of what lies ahead. Even if perfect statistics were available, the level of uncertainty about the future would remain high. Businesses are largely focused on getting the help they need that will carry them through the Lunar New Year holiday in late January 2009. Officials have based their positive scenarios on export orders starting to recover in the spring. How deep and how long will the economic downturn be in China's export markets are key questions that cloud Dongguan's economic future.

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